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RUEHMK/AMEMBASSY MANAMA PRIORITY 0123
RUEHMS/AMEMBASSY MUSCAT PRIORITY 0001
RUEHRH/AMEMBASSY RIYADH PRIORITY 2621
RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY
RUCPDOC/DEPT OF COMMERCE WASHDC PRIORITY

C O N F I D E N T I A L TUNIS 000160

SIPDIS

STATE FOR EEB/IFD/OMA, EEB/EPPD, AND NEA/MAG
(PATTERSON/HAYES)
STATE PASS USTR (BURKHEAD) AND USAID (MCCLOUD)
USDOC FOR ITA/MAC/ONE (MASON), ADVOCACY CTR (TABINE)
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RABAT FOR FAS (HASSAN)
CAIRO FOR FINANCIAL ATTACHE (SEVERENS)
LONDON AND PARIS FOR NEA WATCHER

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TAGS: ECON EFIN EINV ETRD FAO TS
SUBJECT: THE GLOBAL ECONOMIC CRISIS: IMPACT ON TUNISIA

REF: A. TUNIS 154
¶B. TUNIS 44

Classified By: Ambassador Robert F. Godec for reasons 1.4 (b) and (d)

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Summary

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¶1. (C) The global economic crisis is affecting Tunisia, but, so far, to a lesser degree than some other emerging market countries. Tunisia's financial sector, by virtue of its limited development and insulation from international credit markets, remains largely unscathed. However, exports, especially in the auto parts, textiles, and tourism are starting to slump. Foreign direct investment should also see some decline, especially mega-projects funded by Gulf states. Unemployment shows signs of increasing. The GOT has reacted swiftly to the crisis by aiding companies in peril, but its actions will not avert a slowdown of growth. Nevertheless, IMF and private sector economists still project positive real GDP growth for Tunisia in 2009, making it one of the rare countries that will continue to expand. End Summary.

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THE BIG PICTURE: MACRO-ECONOMIC EFFECTS
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¶2. (C) The effects of the global economic crisis on Tunisia are clear and growing, but are overall less dramatic than other countries in the region. According to the World Bank, North Africa will see less of an impact than Europe and Central or South Asia. A visiting International Monetary Fund (IMF) team noted the best projected annual real GDP growth rate for 2009 is 4.5 percent, representing a decrease from 5.1 percent in 2008 and 6.3 percent in 2007. Deutsche Bank Research has a 2009 growth estimate of less than 3 percent year-on-year. The financial sector has hardly been affected by the crisis thanks to its insulation from international credit markets. The Tunisian Dinar (TD) devalued 12.9 percent year-on-year from 2008-2009 against the US dollar.

¶3. (C) Slumping demand in Europe has resulted in a downward trend in exports, especially in the textile, mechanical and electrical components, and tourism sectors. Agriculture exports have also decreased, apparently due to bad harvests. There is some possibility for a counter-balance in textile exports and tourism, as Tunisia may replace other higher-cost markets. The GOT believes remittances will not significantly decrease.

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GOT SWIFT RESPONSE TO THE CRISIS, BIG PLANS AHEAD
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¶4. (C) According to the Nawele Ben Romdhane, Director General of Public Services in the Ministry of Development and International Cooperation (MDIC), some bankruptcies are inevitable, but the GOT is mainly looking at the crisis as an opportunity to deepen reforms and attract investment. MDIC said Tunisia is working toward more integration and increasing FDI incentives, such as cutting down on red tape and decreasing customs fees by six to nine percent over the coming year. The MDIC has commissioned sector studies in health, offshoring and tourism from consultants Ernst and Young. For the short-run, the GOT has come to the rescue of ailing firms, specifically by paying salaries of workers who would otherwise be laid off, covering insurance guarantees for exports, providing short-term loans, and paying partial or full social security contributions. The IMF praised the GOT for monitoring loans closely and taking quick action.

¶5. (C) MFA Director General for the Americas and Asia Elyes Kasri characterized the GOT's short-term reactions as remedial measures. He added that the GOT was continuing its economic modernization efforts and mentioned Open Skies as part of this strategy. He also mentioned his support of regional integration and the revival of the Eizenstat Initiative, which he believed would raise the GDP growth rate of all the Maghreb countries involved by 2 percent. Unemployment remains the single biggest concern for the GOT. Kasri said the economy needs to grow at 6.5 percent to absorb new university graduates.

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FINANCIAL SYSTEM LARGELY UNAFFECTED
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¶6. (C) According to the IMF delegation, Tunisia doesn't face the same problems as some emerging market economies, such as large capital outflows or a credit crunch. The GOT was already overhauling the banking sector when the crisis hit, and Tunisian banks were not trading toxic financial instruments. Structural weaknesses, along with sizable percentage of non-performing loans (NPLs), prevented Tunisia from having a credit boom akin to other emerging markets in the last few years. NPLs made up 17 percent of total loans in 2007. In December 2008, the GOT set a target for NPLs at 10 percent by 2011. Standard and Poor's believes the current NPL figure is 15.5 percent. With roughly 20 commercial banks, the Tunisian banking sector is quite fragmented. However, three of the five largest banks are still state-owned and have a joint market share of 44 percent.

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FISCAL AND MONETARY POLICY UPDATES
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¶7. (C) The IMF noted the GOT's prudent fiscal policies have reduced the public debt ratio from 50.5 percent of GDP in 2007 to 46.9 percent in 2008. Current figures show Tunisia's public debt service ratio declining from 5.3 percent of current income in 2008 to 4.4 percent in 2009. Current share of external debt relative to GDP is 39 percent. The IMF team was surprised to find large reductions in Tunisia's 2008 budget deficits, which they attributed to exceptional oil and tax revenues. However, they believe the positive deficit trend will reverse this year. Private credit growth, even after the onset of the crisis in 2008, remains strong (from

2007-2008 it grew 14.7 percent).

¶8. (C) On monetary policy, the current 4.5 percent interest rate leaves the GOT with ample room to maneuver. A downward inflationary trend has allowed the GOT to slightly reduce the interest rate (from 5.25 percent to 4.5 percent in February 2009) and decrease Tunisia's reserves ratio. Current international foreign exchange reserves stand at 12 percent of GDP, with hard currency reserves actually increasing 25 percent year-on-year (from US $6.5 billion in 2008 to US $8.4 billion in 2009).

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FDI EXPECTED TO DECREASE
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¶9. (C) According to the IMF, FDI currently stands at 6 percent of GDP and has grown in recent years, mostly in the energy sector. However, IMF expects some freezing of projects in all sectors, though it is too early to gauge the real impact. This projection is in contrast to a March 16 statement by Tunisia's Foreign Investment Promotion Agency (FIPA) that FDI increased by 46 percent year-on-year for January and February 2009. There has been media speculation about a halt or slowdown to Gulf Cooperation Council (GCC) investments, especially in the construction sector, although the GOT has denied any outright cancellations. In February, a business sector contact told EconOff the contracting company affiliated with Sama Dubai, the UAE company set to build the large South Lake development in Tunis, had left the country.

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EXPORTS: THE CONSEQUENCES OF EURO-DEPENDENCY
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¶10. (C) Given that 80 percent of Tunisia's exports are destined for the European Union, the downward trend in the value of exports due to the global economic crisis is not surprising. According to the GOT and the IMF, the total value of exports is projected to decrease 17.1 percent in ¶2009. Standard and Poor's estimates a 10 percent decrease in the volume of exports for this calendar year. From 2007-2008, there was a slight decrease (2.8 percent) in the volume of exports. During that same period, however, export values increased 21.8 percent.

¶11. (C) There is a significant difference between export declines in the offshore versus the onshore sectors. For textiles, the onshore sector has seen a decline of 20.4 percent, versus 12.4 percent for offshore enterprises. However, for mechanical and electrical components and other mechanical products, the trend is quite the opposite, with offshore companies seeing a decrease of almost double that of the onshore enterprises in the same industry. Companies in the offshore sector, including some US businesses, have already begun layoffs and have shortened workweeks (Ref B).

¶12. (C) Given the sharp decline in the European automobile sector, Tunisian companies furnishing mechanical and electrical components for this industry are feeling the pinch. Mechanical and electrical components, which make up 26.4 percent of total exports, are expected to decline 17.2 percent in value. STARZ electronics (protect), a small U.S.-owned electronic components company in Bizerte reports automotive electric subcontracting is down by over 50 percent. Faouzi Elloumi (protect), CEO of a multinational electrical auto components manufacturing company, said however, his factory has shifted production towards parts (wire harnesses) for smaller vehicles for the European market and the company has seen 14 percent growth in exports for January/February 2009 over the same months in 2008.

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TEXTILES: NUMBERS LOOK BLEAK, BUT SOME OPPORTUNITIES
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¶13. (C) The textile sector, with a 21.9 percent share in

total exports, is not faring well and is expected to decline 12.6 percent in value. Nazeh Ben Ammar (protect), the owner of an onshore textile production company, notes that automobile textile sales have taken a deep nose dive. A recent survey conducted by Tunisia's Export Promotion Center (CEPEX) identified a decline in overall textile orders (although with slight increases in some seasonal clothing), higher prices for raw materials, and a delay in payments as factors pressing upon the textile sector. There is a silver lining, however. The economic crisis may have some short-run positive effects, since Tunisia may be able to penetrate the market previously captured by China and India. Ben Ammar believes European buyers will look to Tunisia for smaller orders and faster turnaround time.

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AGRICULTURE OUTLOOK MIXED, TOURISM EXPECTED TO DECLINE
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¶14. (C) The value of agricultural and agri-food exports, which represent 20 percent of exports and generate 12 percent of GDP, is expected to decrease by 23.7 percent in 2009. The IMF notes the GOT's agricultural reform so far has been "piecemeal" and although lower commodity prices have benefited Tunisia in the recent years, the sector remains highly regulated. Exports of olive oil, a staple of the export basket, fell by 25 percent from 2008-2009 due to low rainfall. Cereals, as in the past two years, have also fared poorly due to bad harvests. The magnitude of the international crisis' effects on this sector is not clear, as meteorological conditions could also be an important causal factor.

¶15. (C) The tourism sector in Tunisia is also likely to be affected by the global economic crisis. However, it is too early to tell. There have been some reports of lower bookings compared to this season last year, but the IMF representatives said they cannot gauge the impact on the sector yet. The GOT has increased the communications budget for the Ministry of Tourism in order to market Tunisia as an option for tourists who would otherwise travel to more expensive destinations but would downgrade to Tunisia due to cost.

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COMMENT
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¶16. (C) Tunisia's efforts to stem the effects of the economic crisis will not likely mitigate contraction of exports and subsequent job loss, in the short term. Although Tunisia is more sheltered from the effects of this crisis than other emerging markets, its strong ties to Europe have created some vulnerability. The GOT is well aware that slowing growth will only compound their unemployment problem, unless they can increase investment dramatically (Ref A). Although the signs of impact are growing, the true effect of the crisis on some key sectors, such as tourism, remains to be seen. END COMMENT.
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